DOW THEORY LETTERS INC.

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STORM WARNINGS: The cracks in this bear market rally are growing wider. (1) On July 25 the D-J 40-Bond Average broke to 79.90, 8¢ below its 1966 bottom. This was the lowest price for the 40-Bonds since 1933.

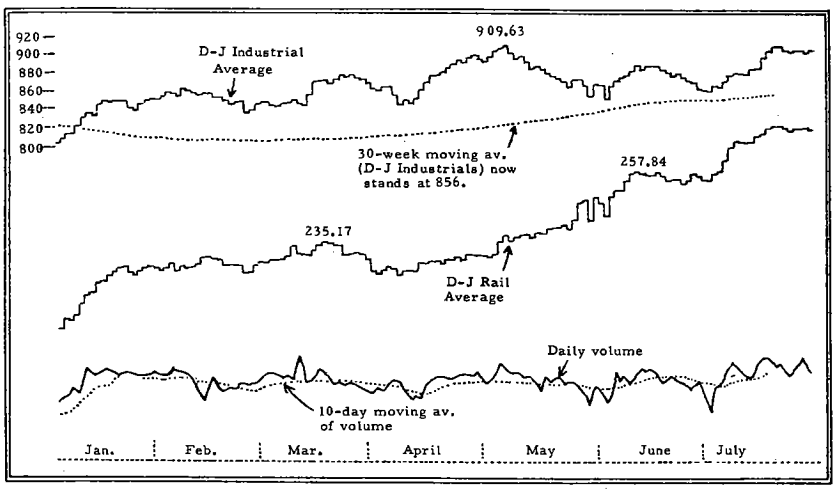
(2) On July 24 the yield on one-year Treasury money (366-day bills) jumped to 5.15%, up from 4.73% the month before. The 5.15% yield is above that of most banks.

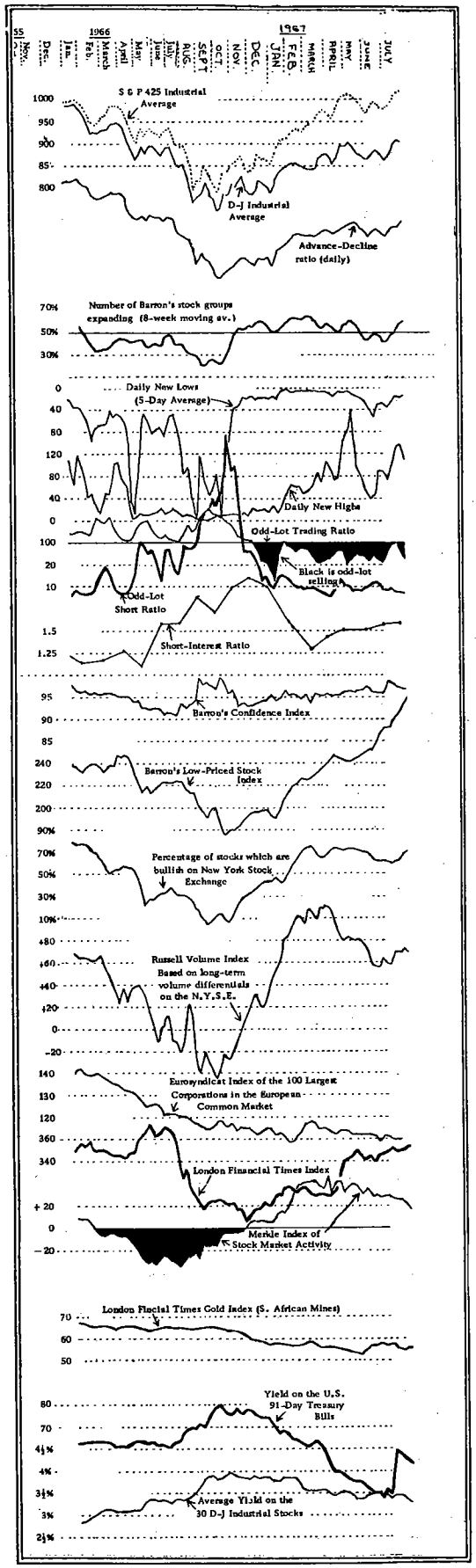
(3) On July 26 the price of gold at the London "fixing" rose to $35.195, a six year high. The London gold pool is committed to hold the price of gold at below $35.20. During the same week Dome Mines, the largest Western gold organization rose to 51 1/8 on the N.Y. S.E., a new high for the year. Gold stocks tend to run counter to the main trend of the market.

(4) Over the past two weeks the social fiber of this nation was shaken as rioting broke out in 15 different cities across the country. I consider this to represent psychological atmosphere for change. Such change could shortly be reflected on Wall Street.

(5) The July 24 issue of LIFE magazine carried a feature article describing the frantic speculation on the Amex. The article points up the crap-shooting, rumor-ridden quality of the 1967 Amex activity. I consider such complete disregard of investment values and such total emphasis on gambling to be ominous for the market and the economy.

THE MARKET: I do not believe I have ever witnessed a market which I felt was so completely "out of kilter." During the week ending July 21, Barron's Low-Priced Stock Index vaulted to a new historic high of 294.4. The negative yield spread between Standard & Poor's Aaa bonds and the S & P 425 Industrial index touched an historic high of 2.44% (in favor of bonds). Volume on the N.Y.S.E. surged to a record peak of 58.1 million shares, while the Dow Industrial issues suddenly came to life, surging 27 points for the week. Signs of "splintering" appeared here and there, and amid frantic speculation such famous "glamor" stocks as Xerox and Polaroid peeled off to lower levels. At the same time the pound sterling sank precariously, sending many gold shares near their highs for the year. President Brand (S. African) hit a record high bid of 15¼, while American-South African rallied to a new high for 1967.




1966
1967
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's stock groups expanding (8-week moving av.)
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-Lot Short Ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index Based on long-term volume differentials on the N.Y.S.E.
Eurosyndicat Index of the 100 Largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Fincial Times Gold Index (S. African Mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

 The week ending July 28 saw the Industrials lose 8 points, but Barron's Low-Priced Index climbed to another historic high of 299. Significantly, the average price of the 20 most active stocks on the N.Y.S.E. dropped to 29.88, the first time that the average price has dropped below 30 in 1967! Obviously, the lower the average price, the more speculative the market.

Meanwhile, the financial eyes of the world continue to focus on Wall Street, and not without concern. Sydney Gampell (Financial Editor for Reuters) noted last week that the American Stock market ".....remains the marvel and the mainstay of the world." He continued, "if Wall Street cracked, goodbye to the hopes of an upsurge in housing and other big-spending consumer durables. If Wall Street holds, it may not by itself suffice to hold up the entire American economy. London may be warning about that." Gampbell was referring to the new collapse of the pound. He was also referring to the other sick economies and markets of Europe.

My own personal opinion is that if the U.S. market cracks, then the repercussion will be comparable to pulling the bottom bricks out of an inverted pyramid. The speculative edifice which is today's Wall Street is holding up everything in its foamy lather of speculative frenzy. If the edifice goes, I believe that mass psychology will turn bearish overnight. I believe that investors and businessmen (who are skeptical enough now) would waste no time in pulling in their horns and racing for the exits.

There are many who are of the opinion that "the market seldom makes sense." But I have always believed that the market makes a great deal of sense, and that it reflects reality, hopes, despair, earnings, future earnings and everything but the advent of an Act of God. When a market is as frothy and hysterical as this one, it is reflecting the speculative mania of the times. But sooner or later markets always adjust to reality. In the past, when the speculation was unreal, the aftermath has always been an ultimate over-dose of pessimism and pain. Let a man eat two quarts of ice cream at a sitting instead of the usual modest scoop and he is likely to get sick and swear off ice cream for the next year. When the market bloats itself on speculative hot air, it is on its way to a thorough deflation and at such times any pin prick will suffice. In my opinion, we are awfully near pin-prick time now. It could happen any day, any week.

What do we do from here on? In my opinion there is no course, no sensible course but to wait out this market. Let the crap-shooters jump in and out, let the gamblers take a chance with a stock like Polaroid (which dropped 18 points in a day) or even American Telephone (which sank from 60 to 52 in little more than a week). This is the rumor stage, the crest of speculation, and to be in this market is to be in the vortex of the speculative hurricane. Money is going to be worth a great deal more six months or a year from now, and your dollar is going to buy a lot more stock before this bear market breathes its last. The great, solid fortunes, in general, have not been made by jumping in on a speculative binge. The fortunes have been made by accumulating solid investment and growth stock at advantageous times, at bear market lows when the average person would not go near Wall Street with the proverbial "ten-foot pole."

MEASUREMENTS: Some subscribers may wonder why I have not been offering the usual studies on odd-lots, short interest ratio, advance-decline ratio, etc., the type of studies which have appeared in this service dozens of times over the past decade. The reason I am not being overly "technical" is because of the market itself. I believe that we have been seeing "mob rule" in the market; it is the kind of atmosphere which can be compared with the scene at the starting line during any one of the gold and land rushes of the nineteenth century.

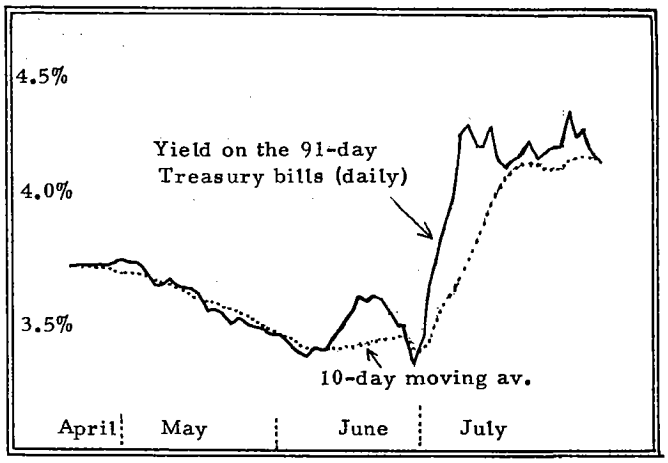
During such periods of mob rule, the measuring sticks are out. Greed and the wish for "a quick buck" know no bounds. Who would have thought that the price of a sandwich would rise to three dollars during the Alaskan gold rush? Who would have guessed that men would kill each other over an unproved gold stake in 1849? Who would believe that worthless junk stocks would "blow their tops" during the bear market rally of 1967? I place these phenomena all in the same category, and there is no yardstick which will measure this type of naked greed.

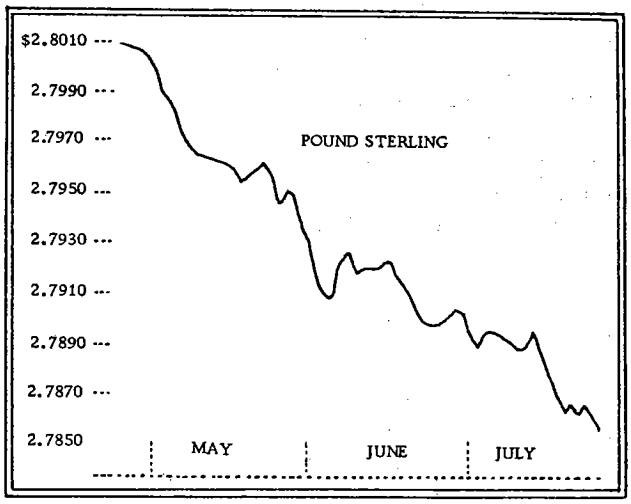
The history of mob psychology suggests that the fever of greed must burn itself out. It does no good to issue warnings. It is of little avail to resort to pious pronouncements. The fire burns bright, and then it goes out. And that is what we are faced with on Wall Street.

To turn to history again, it is well to note that speculative bear rallies are few and far between. They are rarities, but before they are over they invariably leave the crowd battered and in tatters. They usually end as suddenly and mysteriously as they started— and with as little warning. I could include quote after quote from the speculative bear rallies of 1906 or 1930 or 1938. But they would all simply prove one point, that almost no one at the time recognized that these great rallies represented the final fling before major trouble. Few could envision, during those days, that a year later the market would be plunging or in the doldrums, with most stocks far, far below their levels of the speculative peak. History will repeat again, and I feel it will repeat in the very near future.

THE PRESSURE BUILDS: The pressure on the U.S. money market continues. The hope of the bond market continues to be a fat tax hike, a hike which would take in a sufficient amount of money so that forthcoming financing (by the U.S.) would be eased in the money markets. But a tax increase would hit corporate earnings hard, and the Administration knows it. Thus the enigma as to what the Government will do continues. I feel that if this market caves in during the Autumn, the Administration will call off any tax boost. This would result in such a whopping deficit that no one would know what to expect in the money market. Further, if the market topples it would indicate that taxable corporate profits would tumble, further raising the Treasury's deficit. Thus, in a way, everything depends on the stock market holding up.

But if the market holds, then a tax rise is "in the bag," and this in itself will tend to put the brakes on the economy and the market. Thus, the Government in its inflationary folly, in its head-long spending orgy, has built a monster which it dare not kill. A mountain of excess and credit stands towering over the heads of U.S. citizens, and nobody really knows how to climb off the mountain.





Commenting on the situation, the authoritative Daily Bond Buyer (July 24) said: ".....all was made unwell on Tuesday when President Johnson in a news conference fostered uncertainties anew over both the timing and the amount of the tax increase. Read superficially, Mr. Johnson's remarks seemed to indicate that he continued to favor, in due course, a 6% surcharge, which the bond markets know is insufficient; read carefully, Mr. Johnson's remarks were as opaque as an oracle spoken in Delphi."

Last week, amid the Administration pussyfooting and fumbling, the money markets spoke again. On July 24 the 91-day Treasury bills jumped to a new high yield of 4.35%. But the sensational news was that the companion 26-week bills spurted to a 5.04% yield, highest yield since last December. At 5%, this "six-month money" is going to compete directly (again) with bank and savings and loan deposits.

I included this daily chart of the 91-day Treasury bills in the last Letter. I consider it to be one of the most significant charts on Wall Street. Here we see the long bill yield decline into June, the fantastic initial June-July spurt in yields to the 4.24% level, the early-July "correction," and the latest rise to new yield highs.

One of the ramifications of this latest rise in short-term U.S. yields concerns the pound sterling. Sterling has been on the verge of collapse during June and July. Only support from the Bank of England has kept the pound from literally plunging to levels which were tantmount to a forced devaluation. The fact is that Britain's government-sponsored deflationary program has not worked, and the crimping effect of the Mid-East crisis has put further pressure on the pound. Rising interest rates in the U.S. would place (and are placing) even more pressure on the pound. The latest spurt in U.S. 91-day Treasury bills is going to siphon international money out of England and to the U.S. Any and all further rises in U.S. bill rates are going to increase this pressure (on the pound) tremendously.

Jobless Increase Plaguing Britain

New York Times News Service

LONDON—Unemployment in Britain in July set a 27-year high for the month.

Ministry of Labor figures released yesterday showed that rising unemployment is persisting a year after the adoption of severe deflationary measures intended to wipe out the deficit in Britain's international payments.

The report came exactly 12 months after Prime Minister Harold Wilson's administration clamped on the economic brakes harder than any cabinet since World War II. The object of the measures was to sustain the pound at its official value of $2.80 and to earn enough abroad to repay Britain's overseas debts.

WORKED AT FIRST

For a while the program seemed to be working. Britain repaid her borrowings of dollars from other governments and made a big show of repaying the early part of her debt to the International Monetary Fund.

This early success has come into question in the last two months. Partly for fundamental economic reasons, partly because of the Middle East war and the closing of the Suez Canal, the pound has been slipping since May. The chancellor of the exchequer, James Callaghan, no longer predicts a 1967 surplus in Britain's international payments.

Unemployment now is higher than government economists expected.

Against this background of disappointments, 70 Labor members of Parliament urged the government yesterday to forget about sustaining the pound at $2.80 and to give priority to production, jobs, income and welfare. Britain, they said, should stop trying to preserve her traditional role of international banker and should "advance toward socialism in the 1970's."

HIGHEST SINCE '40

The Labor Ministry said the number of persons registered on July 10 as unemployed, including youngsters looking for their first jobs, stood at 496,000, the highest level for the month since the 1940 reading of 779,000.

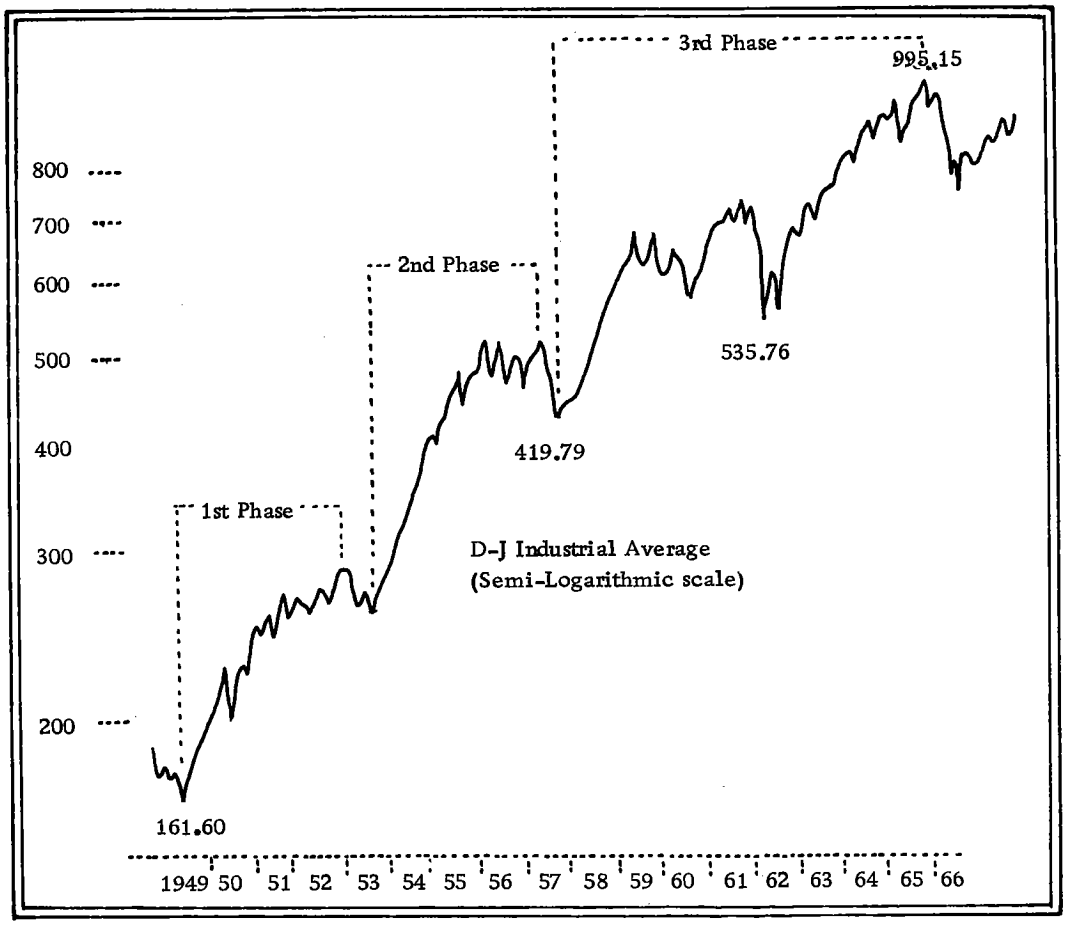
The July unemployment rate was 2.3 per cent. A year ago it was 1.3 per cent and the seasonally adjusted number of jobless was 305,000, or 238,000 less than this month.

The treasury acknowledged last week that unemployment had shot up more and faster than expected. The reason, it said, was that employers were apparently more willing to lay off workers when sales faltered.

I have included a chart of the pound covering the period from April to the present. The chart is self-explanatory. This is steady, persistent weakness. If it continues, it must lead to devaluation. Along these lines, many competent observers believe that devaluation of the pound is only a matter of time. Mr. Alden Wells in his latest report suggests that a proper devaluation would now be in the neighborhood of 30%. The longer the reserves of Britain are dissipated, the greater the ultimate devaluation.

I also include the above news release regarding the tenuous British situation. Political pressure in the face of the sloppy British economy is mounting. Across the face of the world investors are now wondering how and whether the pound will be defended this fall (fall is the time when the pound is under greatest seasonal pressure).

BIG PICTURE: There seems to be a good deal of confusion as to classification of the price action and phases since 1949. Most bull markets undergo three distinct psychological phases, and these phases are frequently (but not always) separated by a secondary (downward) correction. This is what occurred between 1949 and 1966.



I have marked the three phases of the 1949-66 bull market on the accompanying chart. The first phase occurred during 1949 and 1953. This was the early phase of the bull market, and during this phase stocks rebounded from the depressed values of the 1940's. The second phase began from the reaction low of 1953 and carried to the highs of 1956. This is classically the phase wherein the market rises in response to obviously improving business conditions. During the second phase the public is still relatively unaware that a great bull market is in progress.

The third phase of the 1949-66 bull market was extraordinarily long, lasting from the reaction low of 1957 to the 995.15 high of February 7, 1966. During this period the public entered with increasing enthusiasm, and everyone "knew" that a bull market was on.

I put the first phase of the bear market as carrying from February, 1966 to October, 1966. This was a rather atypical first phase for a bear market a typical in that no true "crash" occurred. As a result, although speculative enthusiasm was dampened during 1966, it was not extinguished. The second phase of the bear market began from the 744.32 low of October, 1966, and we are still in the second phase. I feel that this (upward) reaction is, in actuality, the corrective phase that separates the first from the second phase of the bear market. Therefore, when the current advance peters out and turns down, we will be squarely in the midst of the second phase of the bear market. That phase should be accompanied by panic action in many stocks and a steady deterioration in business news. It is in this phase that people will become aware that we are in a true primary bear market. Following the completion of the second phase, the third phase (accompanied by vastly reduced volume) should take stocks down to the final bear market bottom. At those levels, most investment-grade and growth stocks should be selling at great bargain levels. Stocks purchased at those levels will be the bricks from which the next great fortunes will be constructed. It will pay us to wait for the end of the third phase before buying anying in this deceptive, extended primary bear market.

FROM our "When the chips are down, it's gold that counts" Department: "Financial plight of Egypt, in the backwash of the disastrous war, grows more desperate every day. Nasser now is asking women to strip gold wedding rings from their fingers and turn in the family jewels to keep the country running. Men with gold teeth are asked to yank them for the good of the U.A.R." (From U.S. News, July 31, 1967.